Is the optimal inflation target 2%?: Answer from the wealth preference approach

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Since the mid-1990s the Japanese economy has been stagnant, while the US soon recovered after the 2007-2008 financial crisis. Using a macroeconomic model with household wealth preferences, we obtain the conditions of preference, productivity and monetary policy parameters for the full-employment steady state and/or the stagnation steady state to be valid. We apply the Japanese and US data to the conditions and find that both steady states are feasible in Japan while only the full-employment steady state holds in the US. We then obtain the inflation target that is sufficient for the Japanese economy to shift from the stagnation path to the full employment path, the monetary expansion rate that supports it, and the initial price jump due to the shift, causing a vast decline in real financial assets. The welfare effect of the shift is also calculated. It was positive if the policy change occurred before 2005 but negative if it did after 2006.